



COUNTY OF PLACER

OFFICE OF AUDITOR-CONTROLLER

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Ken Grehm, Director
Placer County Department of Public Works
3091 County Center Drive, Suite 220
Auburn, CA 95603

Re: Road Maintenance Division Capital Asset Review – Heavy Equipment

Dear Mr. Grehm:

The Internal Audit Division of the Auditor-Controller's Office performed a review of the capital assets for the Roads Maintenance Division (Division), a division of the Department of Public Works (Department). The objectives of our review were to obtain an understanding of the Division's internal controls over heavy equipment capital assets and capital replacement plan process; assess the control risks; determine if reserves for capital equipment replacement are adequate; and, make recommendations for improvement.

During our review, which consisted of inquiries of the Division's staff regarding current processes, procedures employed by the Division, and analysis of the department's aging equipment maintenance costs, we noted areas where internal controls could be strengthened and operating policies and procedures could be improved. Accordingly, our summary of observations and recommendations are as follows:

Reserves for Capital Asset Replacement

During the review, we noted the Division, which operates within the County Road Fund, does not maintain a reserve for capital asset replacement.

We recommend the Division establish a replacement policy with adequate reserves to replace heavy equipment. Having a funded reserve will assist in enduring catastrophic failures beyond reasonable repair, thus allowing equipment to be replaced immediately and preventing a loss of critical services to the County.

Additionally, we recommend the Division budget to fund the established reserve for capital equipment replacement over the next five years. Approximately fifty percent of the annual

capital replacement budget, approximately \$750,000 - \$900,000, would be sufficient to fund an emergency heavy equipment replacement.

Department's Response:

Although the Road Fund has had a capital replacement reserve in the past, we currently do not have a capital replacement reserve. Our current reserves are as follows:

General	\$5,600,000
Capital Improvement	\$3,000,000
Right-of-way	\$600,000

Our greatest risk within the Road Fund is the catastrophic failure of a piece of transportation infrastructure such as what happened with Morton Road and Foresthill Road years ago. This general reserve currently serves to protect us against all risks we face. The capital improvement reserves consist largely of Caltrans funds we have collected that are designated either generally or specifically to capital projects. The right-of-way reserves are dollars collected from the abandonment/sale of public road easements and by practice have been reserved for other public easement acquisition purposes.

Road Maintenance's current equipment replacement plan requires an annual investment of \$1.5M to maintain. Over the last 4-years we have spent approximately \$4.8M for an average investment of \$1.2M/year. In the last 2-years we have averaged \$1.8M/year in equipment replacement.

Having a more formalized policy for reserves including capital replacement is a good idea. We will develop a policy for road fund reserves that includes capital equipment replacement. We are concerned of the proposed 50% of our annual capital replacement costs since heavy equipment cannot be ordered quickly and typically has a 1-year plus timeframe to obtain. The proposed amounts can be discussed further as we develop and share the proposed policy. Our general reserve of \$5.6M is over 20% of our current operating expenses. Part of the policy development discussion can be the best way to provide reserves for all of Road Maintenance's risks/needs.

We will also need to further discuss the timing of any reserve funding since we are still funding current equipment replacement needs. I would want to get our current fleet in a good sustainable position before funding an equipment replacement reserve.

Capital Replacement Plan

During our review of the capital replacement plan and budget process, we noted the Division does not use trend analysis to analyze maintenance repair trends for each piece of equipment to help determine heavy equipment replacement.

We recommend the division utilize trend analysis for vehicle repair and maintenance costs to help identify and best utilize County resources for heavy equipment replacement for the Master Fixed Asset List. Real time trend analysis will provide the division data to identify the equipment with the highest trending average annual and five year total maintenance and repair costs in comparison to replacement, providing management additional information when determining the capital replacement budget.

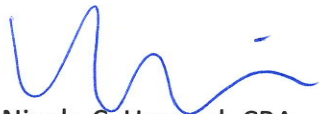
Department's Response:

We have implemented a \$1.5M/year equipment replacement plan that details which specific piece of equipment we plan to replace in the next several years. It is periodically updated based on current information. We based the plan on equipment age and expected useful life; however, we consider increasing repair costs and/or equipment down time. Using more formal metrics, including trend analysis, could improve our decision-making process. We are committed to exploring improved metrics, including some form of trend analysis, when making equipment replacement decisions. We will conduct research on what others are doing and potentially modify our process.

The Department's responses to our recommendations identified by our review are included above. We did not audit their responses and, accordingly, we do not express an opinion on them.

We appreciate the courtesy and cooperation of the Department staff throughout the course of this review.

Respectfully,

A handwritten signature in blue ink, appearing to read 'Nicole C. Howard', with a stylized, flowing script.

Nicole C. Howard, CPA
Assistant Auditor-Controller

cc: Peter Kraatz, Assistant Director of Public Works, Department of Public Works
Matt Lewis, Assistant Road Superintendent, Department of Public Works
Rebeca Solomon, Civil Engineer – Associate, Department of Public Works
Placer County Audit Committee